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Evading the Question: Tanzania's Court of Appeal Ruling Reinforces Importance of Tax Advice When Investing in Emerging Markets

The Tanzanian Court of Appeal has upheld the April 2016 decision of the Tanzanian Tax Revenue Appeals Tribunal that a UK-listed subsidiary (Acacia Mining PLC (Acacia)) of Canadian gold mining parent (Barrick Gold Corporation) entered into "a sophisticated scheme of tax evasion," designed to save US$82 million in income tax, plus penalties and interest.

Set against a backdrop dominated by the evolving G20/OECD Base Erosion and Profit Shifting (BEPS) project, the case is particularly noteworthy for a number of reasons:

- First, it touches on, and gives a uniquely Tanzanian interpretation of, important principles that underpin the operation of the international tax system, including, for example, corporate residence for tax purposes and the nature of "tax evasion."
- Second, it illustrates how fiscal authorities in African countries are increasingly aggressive when asserting their taxing rights and protecting their taxable base, and will go to great lengths to do so.
- Third, it helps emphasize that a proper understanding of double tax treaties (when they are available) can help provide reassurance on some fundamental issues (such as the allocation of taxing rights between multiple jurisdictions) in addition to simply helping reduce withholding tax on payments of interest, dividends and royalties.

The Acacia case, therefore, serves as a sober reminder to companies investing in emerging markets of both the difficulties that can arise in the absence of robust tax structuring and the importance of seeking expert legal advice at the earliest opportunity in order to identify and address the risks.

Tax Residence

Determining where a company is resident for tax purposes, and ensuring that it is not resident anywhere else, sits at the heart of many international tax strategies. Because a jurisdiction's right to tax a company will often arise from that company's residence there, failure to address this most basic of considerations risks inviting double taxation of a company's income, profits and gains.

From the perspective of the relative certainty of the UK, and other OECD-based systems, a company will generally be treated as being resident for tax purposes in a jurisdiction if it is either:

- incorporated; or
- with the notable exception of the US, centrally managed and controlled in that jurisdiction.

On the basis of these long established principles, tax advice will normally focus on ensuring that a company's board does not meet, or make key decisions, in the "wrong" jurisdiction.

Applying these basic rules to Acacia, the company was tax resident in the UK as the company was UK incorporated.

In addition, even though Acacia held one board meeting every four years in Tanzania, the company was also almost certainly controlled and managed in the UK. Central management and control of a company can normally be found where the strategic decisions of the company are made, rather than where the day-to-day administration of the company is carried out. In most cases, central management and control will be exercised during meetings of the company's board.

Dual Residence

One of the consequences of the dual nature of the test of residence is that companies can sometimes be treated as resident in two different jurisdictions (e.g., it is incorporated in country A, but the board meets and makes strategic decisions in country B). On the face of it, the result is that both country A and country B have a claim to tax the company and then the possibility of double taxation arises.

Where a company is treated as tax resident in two jurisdictions and a double tax treaty between those two jurisdictions exists, the treaty will determine which jurisdiction has the right to tax the company. That determination will normally be made by either:

- mutual agreement between the competent authorities; or
- the application of a so-called "tie-breaker" clause, generally based on where the "effective management and control" of the company takes place.

Understanding when, where and how a double tax treaty is available during the initial planning and structuring phase of a proposed transaction or investment is, therefore, just as valuable (if not even more so) than understanding how to claim relief for repatriation payments when the time comes.

If there is no tax treaty, however, the company could be treated as tax resident in both countries. This resulted in a problem for Acacia as there is no double tax treaty between the UK and Tanzania.

Tanzanian Tax Residence

To show that Acacia was liable to tax in Tanzania, however, the Tanzania Revenue Authority would have to show that the company had a taxable presence in Tanzania.

Acacia was not incorporated in Tanzania but, for the purposes of Tanzanian tax law, the company could still be treated as resident if it could be shown to be "formed under the laws" of Tanzania.

Acacia argued that "formed" meant the same as "incorporated." The Tribunal, however, disagreed holding that the word "formed" should carry a broader meaning, wide enough to cover (as argued by the Tanzania Revenue Authority) "all situations for which a company may be established under the laws of [Tanzania]." It seems to us that the Tribunal's interpretation of "formed" here is untenable.

That said, the ruling created a particular problem for Acacia because it had applied for, and been issued with, a Certificate of Compliance by the Business Regulation and Licensing Agency (BRELA) under the Tanzanian Companies Act in order to be able to cross-list its shares on the Dar es Salaam Stock Exchange in 2010. One of the conditions of being granted that Certificate of Compliance is that the company "establish a place of business" in Tanzania.

Having that "place of business," and being granted that Certificate under Tanzanian corporate law, allowed the Tribunal to rule (adopting a purposive approach to statutory interpretation) that Acacia had been "formed" under the laws of Tanzania and was, therefore, tax resident there.

Capital Reduction as Tax Evasion

Tax residence, however, is obviously not enough alone; there must also be income, profits and gains to be taxed.

Acacia owned three subsidiaries that carried on gold mining in Tanzania. Those subsidiaries were the only subsidiaries carrying on a business and Acacia provided management services to them, from the UK, via an office in Dar es Salaam.

All three subsidiaries were, however, loss making, primarily because of tax incentives granted by the Tanzanian government to encourage inward investment from multinational mining companies. As a result, no dividends had been paid by the subsidiaries to Acacia.

So why, in the absence of any income to tax, did the Tanzania tax authorities decide that it was necessary to find Acacia was resident in Tanzania? The justification for the rather strained (as even the Tribunal seems to acknowledge) conclusion, based on an equally strained application of a purposive interpretation of the relevant statute, was that Acacia was participating in a "tax evasion" scheme. In essence, Acacia was accused of illegally shifting its Tanzanian sourced income out of the country to the UK for onward distribution to Canada.

And the evidence for this? Acacia, despite having received no dividends from Tanzania, had paid dividends totaling in excess of US$818 million to its Canadian parent in the period between 2010 and 2014. The Revenue Authority, and the Tribunal, concluded that the only fair explanation for the mismatch was that the arrangements leading to the dividend payments "were simply a design created by [Acacia] aimed at tax evasion."

In reaching that conclusion, the Tribunal seems to ignore the fact that the dividend from Acacia to Barrick Gold Corporation was a special dividend paid followed a capital-raising IPO and an associated capital reduction. That would suggest that the true source of the funds distributed to the Canadian parent came from other investors in Acacia and not from its Tanzanian operation.

It would appear, however, no evidence was taken on the point of English corporate law in question and the Tribunal found it simply could not divorce the payment of the dividends from some underlying source of business revenue. And the only available source for that revenue was the mining operations in Tanzania.

It seems to us that the Tribunal's analysis of the transactions is, therefore, misguided. It inevitably led to the tortuous justification for adopting a purposive interpretation of the law in order to support the Tribunal's overall conclusion in favor of the Revenue Authority's tax demand.

Conclusions

The judgment is at best simply wrong and at worst absurd. It is by no means uniquely bad (although it should be stressed that the quality of tax judgments in some African jurisdictions can be very good), but because the Tanzanian Court of Appeal is the highest available, subject to any other remedy Acacia may obtain under a relevant development or investment agreement, the ruling must stand.

Furthermore, given the particularly strong focus of the international tax community on BEPS, and the increase in efforts to integrate emerging markets into that movement, our expectation is large tax assessments of this nature are likely to become more frequent in the short- to medium-term in many African and other emerging market jurisdictions as they seek to find ways to exercise their taxing power and protect their taxable base.

For all of its shortcomings, taxpayers considering investment in emerging markets should mark the Acacia case as a stark reminder of the importance of exercising extreme care and obtaining early advice from experts. It is only through the documentation, and rigorous application, of appropriately robust tax strategies, structures and processes that investors will be able to minimize the risk of significant tax and dispute resolution costs arising in the future.

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